

2006 Montana Net Operating Loss Instructions

Montana Form NOL

Reference: 15-30-117, MCA and 42.15.116, ARM

Introduction

You may have a Montana net operating loss (NOL) if your deductions for the year are more than your income for the year. Your NOL year is the year that an NOL occurs. Your NOL is either carried back or carried forward and deducted from your income in another year or years.

To have an NOL, your loss has to generally be caused by deductions from your:

- trade or business,
- work as an employee,
- casualty and theft losses,
- moving expenses, or
- rental property.

A loss from operating a business is the most common reason for an NOL.

Non-Resident, Part-year Resident and Composite Tax Return Participants

As a non-resident or a part-year resident you cannot create a Montana net operating loss when you Montana source income (loss) that you reported on Montana Form 2, Schedule IV, line 16 is a loss. When calculating your net operating loss as a non-resident or a part-year resident you have to include in your calculation both your Montana and non-Montana source income that is included on Form 2, line 45.

If you are participating in a composite return filed by your partnership or S corporation you cannot create a Montana net operating loss because your partnership or S corporation reported a Montana loss on the composite return. In order for you to generate a Montana net operating loss as a participating partner or shareholder to generate a Montana net operating loss, you have to file separately a Montana Form 2 reporting your total Montana and non-Montana source income.

How to Figure an NOL

There are rules that limit what you can deduct when figuring your NOL. In general, you are not allowed to include the following items in determining your NOL.

- any deduction for personal exemptions,
- capital losses in excess of capital gains,
- the section 1202 exclusion of 50% of the gain from the sale or exchange of qualified small business stock,
- nonbusiness deductions in excess of nonbusiness income, or
- net operating loss deduction.

When computing your net operating loss, the carrybacks, and carryovers, and the refund limits when your marital or filing status has changed, the federal rules and instructions applicable to these changes in filing status apply.

If you are a non-resident who owns a business that

operates both in and outside of Montana you have to follow the division of income provisions of the Multistate Tax Compact and the principles of allocation and apportionment to determine the amount of your business-wide loss attributable to Montana.

Schedule A

Use Form NOL, Schedule A to figure your NOL.

Line 1. Enter the amount from your 2006 Montana Form 2 line 45. If this is a negative amount, you may have an NOL.

Line 6 – Nonbusiness deductions. Enter on line 6 your deductions that are not related to your trade or business or your employment. Examples of these deductions are:

- alimony,
- contributions to an IRA or other self-employed retirement plan,
- itemized deductions (except for casualty and theft losses and any employee business expenses), and
- the standard deduction (if you do not itemize your deductions).

Do not enter your business deductions that are related to your trade or business on line 6. Examples of these deductions are:

- federal income tax paid on business profits,
- moving expenses,
- the deduction of one-half of your self-employment tax or your deduction for self-employed health insurance,
- rental losses,
- loss on the sale or exchange of business real estate or depreciable property,
- your share of a business loss from a partnership or S corporation,
- ordinary loss on the sale or exchange of stock in a small business corporation or a small business investment company,
- casualty and theft losses (even if they involve nonbusiness property) and employee business expenses (such as union dues, uniforms, tools, education expenses, and travel and transportation expenses) when you itemized your deductions,
- loss on the sale of an accounts receivable (if you use an accrual method of accounting),
- interest and litigation expenses on state and federal income taxes related to your business, and
- unrecovered investment in a pension or annuity claimed on a decedent's final return.

When determining the portion of deductible expenses attributable to income from your trade or business, the expenses have to be multiplied by the ratio of your net income from the trade or business to your Montana adjusted gross income.

When determining the portion of federal tax attributable to

income from your trade or business, the federal tax has to be multiplied by the ratio of your net business income to your Montana adjusted gross income for the year the federal tax was incurred.

Line 7 – Nonbusiness Income. Enter on line 7 only your income that is not related to your trade or business or your employment. For example, enter your annuity income, dividends, and interest on investments. Also, include your share of nonbusiness income from your partnerships and S corporations.

Do not include on line 7 the income you received from your trade or business or your employment. This includes your salaries and wages, self-employment income, and your share of business income from partnerships and S corporations. Also, do not include your rental income or ordinary gain from the sale or other disposition of business real estate or depreciable business property.

Line 17 – Adjustment for Section 1202 Exclusion. Enter on line 17 any gain you excluded under section 1202 on the sale or exchange of qualified small business stock.

Line 19 through Line 22 – Adjustments for Capital Losses. Your amount deductible for capital losses is limited based on whether these losses are business capital losses or nonbusiness capital losses.

Nonbusiness capital losses. You can deduct your nonbusiness capital losses (line 2) up to only the amount of your nonbusiness capital gains without taking into account any section 1202 exclusion (line 3). If your nonbusiness capital losses are more than your nonbusiness capital gains without taking into account any section 1202 exclusion, you cannot deduct the excess.

Business capital losses. You can deduct your business capital losses (line 11) up to only the total of:

- your nonbusiness capital gains that are more than the total of your nonbusiness capital losses and excess nonbusiness deductions (line 10), and
- your total business capital gains without regard to any section 1202 exclusion (line 12).

Line 23 – NOL's from other years. You cannot deduct any of your NOL carryovers or carrybacks from other years. Enter the total amount of your NOL deduction for losses from other years.

When to Use Your NOL

Generally, if you have an NOL for a tax year ending in 2006, you have to carry back the entire amount of the NOL to the two tax years before your NOL year (this is called the carryback period), and then carry forward any of your remaining NOL for up to 20 years after your NOL year (this is called the carryforward period). However, you can choose not to carry back your NOL and only carry it forward. You cannot deduct any part of your NOL that remains after the 20-year carryforward period.

NOL year. This is the year in which your NOL occurred.

Exceptions to Two-Year Carryback Rule

You can qualify for a longer carryback period if you have

eligible losses or farming losses.

Eligible loss. The carryback period for eligible losses is three years. You have an eligible loss if any part of your NOL is:

- from a casualty or theft, or
- attributable to a Presidentially declared disaster for a qualified small business.

Qualified small business. You have a qualified small business if you are a sole proprietorship or a partnership that has average annual gross receipts (reduced by returns and allowances) of \$5 million or less during a three-year period ending with the tax year of your NOL. If your business did not exist for the entire three-year period, use the period your business was in existence.

Farm loss. When you have a farm loss, you carryback period is five years. Your farming loss is the smaller of:

- the amount that would be the NOL for the tax year if only the income and deductions attributable to your farming businesses were taken into account, or
- the NOL for the tax year.

Farming business. You have a farming business if your trade or business is involved with the:

- cultivation of land,
- raising or harvesting or any agricultural or horticultural commodity,
- operating a nursery or sod farm,
- raising or harvesting a tree bearing fruit, nuts, or other crops, or ornamental trees.
- the raising, shearing, feeding, caring for, training and management of animals is also considered a farming business.

You do not have a farming business if:

- you perform contract harvesting,
- someone else grows or raises an agricultural or horticultural commodity for you, or
- you merely buy or sell plants or animals grown or raised by someone else.

Waiving the Five-year Carryback

You can choose to treat a farming loss as if it were not a farming loss. If you make this choice, your carryback period will be 2 years. To make this choice, indicate the carryback years in the box provided for you on Schedule A before the due date (including extensions). Once you waive the five-year carryback, you cannot revoke it.

If you choose not to carryback any of your farming loss, check the appropriate box on Schedule A that states that you are electing to forgo the carryback and carryforward your farming loss.

Waiving the Carryback Period

You can choose not to carryback your NOL. If you make this choice, then you can use your NOL only during the 20-year carryforward period.

If you want to make this choice, check the box on Schedule A, electing to forgo the carryback of your NOL. This election has to be made by the due date (including extension of time) for filing your tax return for the tax year of your NOL. Once you elect to waive the carryback period, you cannot revoke

it. If you choose to waive the carryback period for more than one NOL, you have to make a separate election for each of your NOL years.

Schedule B

You will have to complete and file Schedule B to determine your NOL deduction for each carryback year and the amount that will be carried forward, if it has not already been fully absorbed.

If your NOL is more than your Montana modified taxable income for the earliest year that it is carried to, you will have to file Schedule B to figure the amount of your NOL that will be carried to the next tax year. The amount of your carryover is the excess, if any, of your NOL carryback over your modified taxable income for that earlier year. Your Montana modified taxable income is the amount figured on line 8 of Form NOL, Schedule B.

If you carry two or more NOLs to a tax year, figure your modified taxable income by deducting the NOLs in the order that they were incurred.

Line 1 – Enter the amount shown on Form NOL, Schedule A to the appropriate carryback year. See “When to Use an NOL” discussion above to determine your carryback year. If your NOL is not fully absorbed in a year that it is carried to, complete Schedule B to figure the amount of your NOL carryover to the next year.

Line 2 – Do not take into account on this line any NOL carryback from 2006 or later. However, do take into account NOLs that occurred in tax years before 2006 and are otherwise allowable as carrybacks or carryovers.

Line 3 – Net Capital Loss Deduction

Individuals. Enter as a positive number the amount, if any, shown (or as previously adjusted) on Schedule D (Form 1040). If you are married filing separately for Montana, include the capital loss limitation adjustment in calculating your Montana adjusted gross income.

Estates and trusts. Enter as a positive number the amount, if any, shown (or as previously adjusted) on Schedule D (Form 1041).

Line 4 – Section 1202 Exclusion. Enter as a positive number any gain that you excluded under section 1202 on the sale or exchange of qualified small business stock.

Line 5 – Adjustments to Montana Adjusted Gross Income. If you entered an amount on line 3 or line 4, you have to refigure certain income and deductions based on your Montana adjusted gross income.

These include:

- the special allowance for passive activity losses from rental real estate activities,
- Montana taxable social security benefits,
- IRA deductions,
- excludable savings bond interest,
- student loan interest deduction, and
- tuition and fees deduction.

For purposes of figuring your adjustment to each of these items, your Montana adjusted gross income is increased by the total of the amounts on line 3 and line 4. Do not take into account any of your NOL carryback from 2005 or later.

Line 6 – Adjustment to Itemized Deductions.

Individuals. Skip this line if, for the applicable carryback year:

- you did not itemize deductions, or
- the amounts on Schedule B, line 3 and line 4, are zero.

Otherwise, complete lines 10 through 34 and enter on line 6 the amount from line 34 (or, if applicable, line 12 of the itemized deduction worksheet on Form NOL, page 2).

Line 9 – NOL Carryover. After completing all applicable columns, carry forward to 2007 the amount, if any, on line 9 of the column for the 1st preceding tax year.

Line 21 – Refigured Charitable Contributions. Refigure your charitable contributions using line 21 as your adjusted gross income unless, for any preceding tax year:

- you entered an amount other than zero on line 19, and
- you had any items of income or deductions based on adjusted gross income that are listed in the instructions for line 5 of Schedule B above.

Schedule C

Use Schedule C, Form NOL to summarize your NOL absorption.

NOL Generated. Enter the amount of your NOL generated as reported on Schedule A, line 24.

NOL Absorbed. Enter the amount of your NOL absorbed as reported on Schedule B, line 8.

NOL Balance. Remaining balance of your NOL to be applied to your next carryover period.